SHARES AND CAPITAL GAINS TAX

This Help Sheet explains the basic rules which apply to the acquisition and disposal of shares by individuals, personal representatives and trustees in the tax year 2000-2001. It helps you work out the capital gain or loss if you have disposed of shares in that tax year. This Help Sheet explains only the basic rules, as they apply in simple cases. If you are in any doubt about your circumstances, ask your Inland Revenue office or tax adviser for advice. You can consult the Inland Revenue Capital Gains Manual, which explains the rules in more detail. The Manual is available on the Inland Revenue website at www.inlandrevenue.gov.uk or you can ask to see it at your local Inland Revenue Enquiry Centre.
The Help Sheet explains:

- **why special rules are needed**
- **how you identify the shares disposed of**
- **how you work out the gain under the 'bed and breakfasting' rule**
- **how you work out the gain if the shares were acquired after 5 April 1998**
- **how you work out the gain if the shares are held in a Section 104 holding**
- **how you work out the gain if the shares are held in a 1982 holding**
- **how you work out the gain if the shares were held on 6 April 1965**
- **the treatment of units in a unit trust**
- **the treatment of privatisation shares.**

The Help Sheet refers to acquisitions and disposals. These are not restricted to purchases and sales although they will be the most common events. An important exception is that share reorganisations such as rights and bonus issues, or an issue of shares on a company take-over, are not treated as acquisitions. See *Help Sheet IR285: Share reorganisations, company take-overs and Capital Gains Tax* available from the Orderline.

This Help Sheet also assumes that the capital gain or loss will be calculated using the actual costs of acquisition and the actual disposal proceeds. Pages CGN13 and CGN14 of the Notes on Capital Gains explain the circumstances in which market value must be substituted for actual cost or disposal proceeds.

Help Sheet IR287: Employee Share Schemes and Capital Gains Tax explains more about shares which you acquire in connection with your employment or by exercising an employee share option. This is available from the Orderline.

Help Sheet IR295: Relief for gifts and similar transactions explains more about the capital gains treatment of gifts, including gifts to charity. *Help Sheet IR342: Charitable Giving* tells you about the income tax relief available for gifts of certain shares, securities and other investments to charity.

WHY ARE SPECIAL RULES NEEDED?

Shares of the same class in the same company are identical. Suppose you have a holding of 10,000 Bits and Bobbs plc 25p ordinary shares acquired at different times for different prices. You then sell 2,000 shares. To calculate the gain you need to know firstly, which shares you have sold and secondly, how much they cost.

You also need to know how long you held the shares you have sold in order to work out how much taper relief is due (see page CGN17 of the Notes on Capital Gains). The capital gains rules for shares enable you to do this.

For historical reasons shares of the same class in the same company may be grouped in different ways:

- acquisitions of shares on or after 6 April 1998 are kept as separate acquisitions (but all acquisitions on one day are treated as a single acquisition)
- acquisitions of shares between 6 April 1982 and 5 April 1998 are kept in a 'pool', called a Section 104 holding. The cost of the shares in the pool is added together: each share in the pool is treated as if acquired at the same average cost
- acquisitions of shares between 7 April 1965 and 5 April 1982 are kept in a different 'pool', called a 1982 holding. Again, the cost of the shares in the pool is added together, with each share being treated as if acquired at the same average cost
- shares held at 6 April 1965 are not pooled.

Example 1
Suppose you bought 10,000 Bits and Bobbs plc 25p ordinary shares as follows:

16 June 1979	2,000 shares
2 August 1982	2,500 shares
17 September 1987	2,500 shares
7 June 1998	3,000 shares.

You would have:

- a separate acquisition of 3,000 shares - the 1998 purchase
- a Section 104 holding pool of 5,000 shares - the 1982 and 1987 purchases
- a 1982 holding pool of 2,000 shares - the 1979 purchase.

HOW TO IDENTIFY THE SHARES DISPOSED OF

When you dispose of shares you cannot work out your capital gain or loss until you have matched the shares disposed of with shares you acquired.

You are treated as disposing of shares in the following order:

First, shares acquired on the same day.

Second, shares acquired in the 30 days following the day of disposal (the 'bed and breakfasting' rule).

Third, shares acquired after 5 April 1998, taking the most recent acquisitions first (a last in, first out, or 'LIFO' basis).

Fourth, shares in the Section 104 holding.

Fifth, shares in the 1982 holding.

Sixth, shares held on 6 April 1965.

If the above rules fail to exhaust the shares disposed of, the remaining shares are matched with later acquisitions, taking the earliest one first.

Example 2

Mr Smith owns 10,000 shares

500	were purchased on 30 April 1998
2,500	are held in a Section 104 holding
7,000	are held in a 1982 holding.

Mr Smith sells 4,000 shares on 11 October 2000.
The disposals are identified as:

500	against the shares purchased on 30 April 1998
2,500	against the shares in the Section 104 holding
1,000	against the shares in the 1982 holding.

HOW YOU WORK OUT THE GAIN UNDER THE 'BED AND BREAKFASTING' RULE

If a disposal of shares is identified with shares acquired within the following 30 days, the gain or loss on disposal is the difference between the net disposal proceeds and the acquisition cost.

Example 3

Mrs Robson bought 2,000 shares in 1984 for a total cost of £3,640. (These shares form a Section 104 holding pool.)
On 26 February 2001 she sells 1,500 shares for £10,265 (net of disposal costs). On 1 March 2001 she buys another 1,800 of the same shares at a cost of £12,420.

The disposal of 1,500 shares is **not** matched with shares in the pool. It is identified with 1,500 of the shares bought on 1 March 2001. The gain or loss on disposal is calculated as follows:

Disposal proceeds		£10,265
Allowable cost	$\frac{1,500}{1,800} \times £12,420 =$	£10,350
Loss		£85

Note: if Mrs Robson had bought only 1,000 shares on 1 March 2001, 1,000 of the shares sold on 26 February would have been matched with that later acquisition, and the remaining 500 shares sold would have been matched with 500 of the shares in the pool. The gain or loss would have been calculated accordingly.

HOW YOU WORK OUT THE GAIN IF THE SHARES WERE ACQUIRED AFTER 5 APRIL 1998

If a disposal of shares is matched, on the LIFO basis, with shares acquired after 5 April 1998, the gain or loss on disposal is the difference between the net disposal proceeds and the acquisition cost.

Example 4

Mr Quinn buys 1,000 shares on 23 April 1998 at a cost of £4,420. On 30 November 1998 he buys 800 of the same shares for £3,935. On 1 March 2001 he sells 1,050 shares for £4,910.

The first step is to match the disposal with acquisitions. Taking the latest acquisition first (the LIFO basis), 800 of the shares sold are identified with the shares bought on 30 November 1998. The remaining 250 are identified with 250 of the 1,000 shares bought on 23 April 1998.

The gains or losses are calculated as follows:

Disposal of 800 shares

Proceeds	$\frac{800}{1,050} \times$	£4,910	=	£3,741
Allowable cost				£3,935
Loss				£194

Disposal of 250 shares

Proceeds	$\frac{250}{1,050} \times$	£4,910	=	£1,169
Allowable cost	$\frac{250}{1,000} \times$	£4,420	=	£1,105
Gain				£64

HOW TO WORK OUT THE GAIN FOR SHARES IN A SECTION 104 HOLDING

The Section 104 holding consists of two pools of expenditure, a pool of actual cost and a pool of indexed cost. (Section 5 beginning on page CGN14 of the Notes on Capital Gains explains indexation.) The pool of indexed cost is the actual cost plus indexation. Both pools are adjusted each time an 'operative event' occurs. An 'operative event' is anything which reduces or increases the value of the pool of actual cost. Purchases and sales of shares are the most common examples of operative events.

The basic steps for working out a gain (or loss) on a disposal of shares in a Section 104 holding are as follows:

Step 1 The Section 104 holding was formed when you first acquired shares between 6 April 1982 and 5 April 1998. At this stage the pool of actual cost and the pool of indexed cost are the same.

Step 2 When you dispose of, or next acquire, shares **before 6 April 1998** you add indexation to the pool of indexed cost. You do this by multiplying the pool of indexed cost by the indexation factor for the period between Step 1 and Step 2 and by adding this figure to the pool of indexed cost. If the event is an acquisition, you then add the allowable expenditure on the new shares to the pools of actual cost and indexed cost. If the event is a disposal, the two pools are each reduced by the fraction which relates to the shares disposed of. The fraction is:

$$\frac{\text{Number of shares sold}}{\text{Total number of shares in the pool}}$$

Step 3 When you acquire shares **on or after 6 April 1998**, the shares are not added to the Section 104 holding. Instead they are kept as separate acquisitions, as explained above. The Section 104 holding will increase in size on or after 6 April 1998 only if there is a share reorganisation and you receive additional shares of the same class. If you receive extra shares in a share reorganisation on or after 6 April 1998, the procedure in Steps 3 and 4 will be modified. For further information see *Help Sheet IR285: Share reorganisations, company take-overs and Capital Gains Tax.*

When you first dispose of shares in the Section 104 holding **on or after 6 April 1998**, you add indexation **up to April 1998** to the pool of indexed cost. You then calculate the gain or loss. If all the shares in the pool are disposed of, the allowable expenditure is the pool of actual cost. Indexation allowance is the difference between the pools of actual cost and indexed cost. If only some of the shares are disposed of, the allowable expenditure is a fraction of the pool of actual cost. The fraction is:

$$\frac{\text{Number of shares sold}}{\text{Total number of shares in the pool}}$$

You apply the same fraction to the pool of indexed cost. The indexation allowance is the difference between the fractions of the allowable cost and indexed cost. The indexation allowance given is restricted if it would create or increase a loss.

Step 4 If any shares remain in the pool, after Step 3, the allowable expenditure on a later disposal is the relevant fraction of the pool of actual cost remaining after deducting the cost of the earlier disposal. You do not add any more indexation to the pool of indexed cost. The indexation allowance available on the later disposal is the difference between the relevant fractions of the allowable cost and indexed cost. The indexation allowance given is restricted if it would create or increase a loss.

Example 5 on pages 4 and 5 shows you how to work this out.

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Example 5
In April 1992 Mrs Patel buys 1,000 XYZ plc shares for 400p per share plus dealing costs of £150 including VAT. This is her first acquisition of XYZ plc shares.

In September 1994 she buys a further 500 XYZ plc shares for 410p per share plus dealing costs of £80 including VAT.

In May 2000 she sells 700 XYZ plc shares for 480p per share (£3,360 disposal proceeds), incurring dealing costs of £100 including VAT.

In February 2001 she sells 400 XYZ plc shares for 520p per share (£2,080 disposal proceeds), incurring dealing costs of £105 including VAT.

	Number of shares	Pool of actual cost	Pool of indexed cost
Step 1 **April 1992** The Section 104 holding pool is formed	1,000	£4,150	£4,150
Step 2 **September 1994**			
Give indexation from April 1992 to September 1994. Multiply the pool of indexed cost at Step 1 by the indexation factor and add this to the pool of indexed cost £4,150 x 0.045* = £187. Add the allowable expenditure on the new shares to the pools of actual cost and indexed cost			
Add indexation			£187
Add cost of further shares	500	£2,130	£2,130
	1,500	£6,280	£6,467

***Note:** The indexation factor (0.045) here **cannot** be taken from the table on page CGN16 of the Notes on Capital Gains. This is because the operative event occured before April 1998. Your Inland Revenue office or tax adviser can supply the right figures to use for any months before April 1998.

Step 3 **May 2000**			
Give indexation from September 1994 to April 1998. Multiply the pool of indexed cost by the indexation factor and add this to the pool of indexed cost: £6,467 x 0.121 = £783			£783
	1,500	£6,280	£7,250

To calculate the gain or loss.

First, calculate the amount of allowable expenditure and indexation allowance available.
Multiply the two pools of cost by:

$$\frac{\text{Number of shares sold}}{\text{Total number of shares in the pool}} = \frac{700}{1{,}500}$$

Indexed cost	£7,250 x 700/1,500	=	£3,383
Actual cost	£6,280 x 700/1,500	=	£2,931
Indexation allowance			£452

Second, calculate the gain or loss

Disposal proceeds		£3,360
minus allowable cost	£2,931	
Costs	£100	£3,031
Unindexed gain		£329
minus indexation allowance (restricted)		£329
Chargeable gain		0

Notes on calculation

1. Indexation allowance cannot create or increase a loss. In this example, the indexation allowance given has been restricted to avoid creating a loss. If the indexation allowance is restricted, you still reduce the pool of indexed cost by the full amount of the relevant fraction of indexed cost (£3,383 in this example).
2. Indexation allowance has been calculated using the indexation factors rounded to three decimal places.
3. Fractions of actual cost and indexed cost have been calculated by reference to the number of shares held. Alternatively, you can use the fraction:

$$\frac{\text{Disposal proceeds}}{\text{Disposal proceeds + value of shares not sold}}$$

Third, adjust the two pools in the Section 104 holding

	Number of shares	Pool of actual cost	Pool of indexed cost
Brought forward	1,500	£6,280	£7,250
	minus 700	*minus* £2,931	*minus* £3,383
Carried forward	800	£3,349	£3,867

Example 5 (continued)

	Number of shares	Pool of actual cost	Pool of indexed cost
Brought forward	800	£3,349	£3,867

Step 4 **February 2001**

Do not add any further indexation to the pool of indexed cost

Calculate the gain or loss.

First, calculate the amount of allowable expenditure and indexation allowance available.
Multiply the two pools of cost by:

$$\frac{\text{Number of shares sold}}{\text{Total number of shares in the pool}} = \frac{400}{800}$$

Indexed cost	£3,867 x $\frac{400}{800}$	=	£1,934
Actual cost	£3,349 x $\frac{400}{800}$	=	£1,675
Indexation allowance			£259

Second, calculate the gain or loss

Disposal proceeds		£2,080
minus allowable cost	£1,675	
Costs	£105	£1,780
Unindexed gain		£300
minus indexation		£259
Chargeable gain (before taper relief)		£41

Third, adjust the two pools in the Section 104 holding

	Number of shares	Pool of actual cost	Pool of indexed cost
Brought forward	800	£3,349	£3,867
	minus 400	*minus* £1,675	*minus* £1,934
Carried forward	400	£1,674	£1,933

HOW TO WORK OUT THE GAIN FOR SHARES IN A 1982 HOLDING

A 1982 holding is also a pool of shares. Unless there is a rights or bonus issue (in which case see *Help Sheet IR285: Share reorganisations, company take-overs and Capital Gains Tax*) you cannot add to the number or value of the shares in this holding. In fact, most quoted companies have made share reorganisations since 1982 and you will probably need to refer to the Help Sheet. The ordinary rules applying to all assets held at 31 March 1982 also apply to 1982 holdings. These rules are explained in *Help Sheet IR280: Rebasing - assets held at 31 March 1982.*

If you have made an election for the 31 March 1982 value to apply to all your assets, the shares in the 1982 holding will be held at their value on that day. If the shares were not quoted on a recognised Stock Exchange on 31 March 1982, you or your professional adviser will have to provide a valuation. Your Inland Revenue office will want to check that valuation.

HOW TO WORK OUT THE GAIN IF YOU HAVE HELD THE SHARES SINCE 6 APRIL 1965

Any shares you have held since 6 April 1965 will have been held on 31 March 1982. These shares will be covered by any election you have made to have the gain calculated only by reference to the 31 March 1982 value.

If you have not made an election, please ask your Inland Revenue office for details of:

- how you make the comparison with the gain calculated by reference to the 31 March 1982 value
- how you can make an election for quoted shares to be included in a 31 March 1982 holding.

UNITS IN A UNIT TRUST

Unit trust units are treated as if they are shares in an ordinary company. The basic rules described in this Help Sheet apply equally to such units (and also to shares in an investment trust or an open ended investment company). But there are some extra points to note.

If you hold accumulation units you will not receive distributions of income from the trust. Instead the income is retained and reinvested automatically for you (a 'notional distribution'). You do not receive any new units, but the value of your existing units is increased. If you receive notional distributions which are subject to income tax, the amount of these distributions is allowed as additional expenditure on your accumulation units.

— Accumulation units

If you bought your units before April 1998 you will be entitled to indexation allowance up to that month

- on the original cost - from the month the accumulation units were acquired
- on each notional distribution - from the month you became entitled to it.

Example 6

Suppose you buy accumulation units on 19 January 1997.
You become entitled to notional cash distributions on 1 July 1997, 2 January 1998 and 1 July 1998.

Indexation allowance will run

- from January 1997 to April 1998 on the cost of the units
- from July 1997 to April 1998 on the first notional distribution
- from January 1998 to April 1998 on the second notional distribution.

No indexation allowance will be due on the third notional distribution, which was after March 1998 (nor on any later ones).

— Taper relief

For taper relief purposes, the qualifying holding period of accumulation units starts on 6 April 1998 or, if later, the date when you first bought them. Any notional distributions you receive are ignored. In contrast, if you hold income units and the income is reinvested in additional units, these are treated as fresh acquisitions of new shares and the qualifying holding period runs from the date of each separate acquisition. For more information on taper relief see *Help Sheet IR279: Taper Relief.*

Many unit trusts offer both accumulation units and income units. These are treated as different classes of share and gains and losses calculated accordingly. If you hold accumulation units and switch to income units in the **same** unit trust - or you switch from income to accumulation units in the **same** unit trust - the switch is not treated as a disposal of your units. Instead it is treated as a share reorganisation, see *Help Sheet IR285: Share reorganisations, company take-overs and Capital Gains Tax.*

— Umbrella Schemes

A unit trust may take the form of an 'umbrella scheme' authorised by the Financial Services Authority. These schemes have separate sub-funds which are treated as separate authorised unit trusts for capital gains tax purposes. A switch from units in one sub-fund to units in another will normally be a disposal of the old units, on which a capital gain or loss will arise. But if the switch occurs as part of a merger of sub-funds, the rules described in *Help Sheet IR285* may apply. If so, you are not treated as disposing of your old units at the time of the merger.

— Monthly Saving Schemes

Many authorised unit trusts, and also authorised investment trusts and open ended investment companies, offer investors monthly saving schemes. The Inland Revenue has issued a Statement of Practice SP2/99 covering the capital gains tax treatment of units and shares in monthly schemes. Your Inland Revenue office can give you a copy of SP2/99 and the Press Release 'Monthly Savings in Investment Funds', dated 31 March 1999, which accompanied it.

PRIVATISATION SHARES

Nearly all sales of shares in privatised companies by the Government have two features:

- the shares are paid for by instalments
- shareholders can choose different incentives. Usually they include either the payment of lower instalments or the issue of bonus shares after a specified period.

— Treatment of instalment payments

If you buy the shares from the Government, you are entitled to indexation allowance (up to April 1998 for disposals in that month or later) on the full amount you agree to pay from the date you acquire the shares. For example, shares in Loamshire Electricity plc cost 240p each, 100p payable on application, 70p by 22 October 1991 and 70p by 15 September 1992. If, as a result of the application, you acquired 300 shares in December 1990 you would be entitled to indexation allowance on £720 from December 1990.

If you sell some or all of the shares before all the instalments have been paid you should **either:**

- reduce the cost of the shares by the unpaid instalments, **or**
- increase the disposal proceeds by the amount of the unpaid instalments.

You may buy shares from a broker before all the instalments have been paid by the previous owner. For Capital Gains Tax purposes your allowable expenditure is the amount you pay the broker plus the cost of the further instalments you have to pay. Indexation allowance (up to April 1998 for disposals in 1998-99) is given on the full amount from the date you acquire the shares from the broker. The same rules apply if you inherit the shares or are given them with instalments outstanding, but instead of the amount paid to the broker you take the market value of the shares on the day you acquire them.

— Reduced instalments

Shareholders may choose the incentive which allows them to make reduced instalment payments. For the original shareholder the tax treatment is the same as that described in the first two paragraphs of the 'Treatment of instalment payments' section but the references to instalments are to the reduced amount of the instalments.

The entitlement to pay reduced instalments may cease on a transfer of the shares. If you acquire the shares from a shareholder who has chosen this incentive before all the instalments are paid and you have to pay the full amount on the remaining instalments, your acquisition cost will include the full amount of the instalments you have to pay. If you take over the right to make the reduced payments, your acquisition cost will include the lower instalments you have to pay.

Indexation allowance (up to April 1998 for disposals in that month or later) is given on the amount paid to acquire the shares, together with the further instalments **you** have to pay.

— Loyalty bonus shares

In most privatisations shareholders who acquire shares from the Government and hold them for a specified period may, if they choose this form of incentive, receive an issue of extra shares. These shares are treated as acquired at their market value. For example, a shareholder in Big City Electric plc who acquired 400 50p shares on the privatisation and still held them on 31 December 1993, may receive an extra 40 shares. The market value of Big City Electric plc 50p shares on 31 December 1993 was 657½p. The total acquisition cost of the bonus shares would be £263.

As an alternative to receiving bonus shares, customers may have chosen to receive vouchers that can be set against bills received from the privatised company. There is no tax liability on the receipt or use of these vouchers. For Capital Gains Tax purposes the acquisition cost of the shares is reduced by the amount of the vouchers.

These notes are for guidance only, and reflect the position at the time of writing. They do not affect any rights of appeal.